Supreme Court, U.S.
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No.

In the
SUPREME COURT OF THE UNITED STATES

RONALD J. SOMMERS, TRUSTEE,
Petitioner,

v.

WELLS FARGO BANK OF TEXAS, N.A.,
Respondent.

On Petition For A Writ of Certiorari to the
United States Court of Appeals for the Fifth Circuit

PETITION FOR A WRIT OF CERTIORARI

STACY OBENHAUS
(*Counsel of Record*)
JAMES P. REID
DAVID ELDER
LISA HONEY
GARDERE WYNNE SEWELL LLP
3000 Thanksgiving Tower
1601 Elm Street
Dallas, Texas 75201-4761
(214) 999-3000
Counsel for Petitioner

QUESTIONS PRESENTED

I. If a bankruptcy court modifies the automatic stay in effect under 11 U.S.C. § 362 and allows a creditor to pursue state law claims against a third party, are bankruptcy law remedies affecting that third party barred?

II. If a bankruptcy trustee agrees not to oppose a creditor's request to modify the automatic stay and pursue state law claims against a third party, is the bankruptcy trustee estopped from asserting bankruptcy law remedies against that third party?

PARTIES TO THE PROCEEDINGS BELOW

Appellant:

Wells Fargo Bank of Texas, N.A.

Appellee:

Ronald J. Sommers, Trustee

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OPINIONS AND JUDGMENTS BELOW

A separate appendix to this petition contains the opinions that the courts below issued. The opinions are as follows:

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Wells Fargo Bank of Texas, N.A. v. Sommers, Trustee, 444 F.3d 690 (5th Cir. 2006)

JURISDICTION

The court of appeals entered its judgment on March 31, 2006. Sommers filed a petition for rehearing on April 14, 2006. The Fifth Circuit Court of Appeals denied the petition for rehearing on May 4, 2006. This Court's jurisdiction to review the court of appeals' judgment arises from 28 U.S.C. § 1254(1).

STATUTES INVOLVED

11 U.S.C.A. § 362(d) (West 2004 & Supp. 2006)

On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest;

(2) with respect to a stay of an act against property under subsection (a) of this section, if--

(A) the debtor does not have an equity in such property; and

(B) such property is not necessary to an effective reorganization;

(3) with respect to a stay of an act against single asset real estate under subsection (a), by a creditor whose claim is secured by an interest in such real estate, unless, not later than the date that is 90 days after the entry of the order for relief (or such later date as the court may determine for cause by order entered within that 90-day period) or 30 days after the court determines that the debtor is subject to this paragraph, whichever is later—

(A) the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or

(B) the debtor has commenced monthly payments that—

(i) may, in the debtor's sole discretion, notwithstanding section 363(c)(2), be made from rents or other income generated before, on, or after the date of the

commencement of the case by or from the property to each creditor whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured statutory lien); and

(ii) are in an amount equal to interest at the then applicable nondefault contract rate of interest on the value of the creditor's interest in the real estate; or

(4) with respect to a stay of an act against real property under subsection (a), by a creditor whose claim is secured by an interest in such real property, if the court finds that the filing of the petition was part of a scheme to delay, hinder, and defraud creditors that involved either—

(A) transfer of all or part ownership of, or other interest in, such real property without the consent of the secured creditor or court approval; or

(B) multiple bankruptcy filings affecting such real property.

If recorded in compliance with applicable State laws governing notices of interests or liens in real property, an order entered under paragraph (4) shall be binding in any other case under this title purporting to affect such real property filed not later than 2 years after the date of the entry of such order by the court, except that a debtor in a subsequent case under this title may move for relief from such order based upon changed circumstances or for good cause shown, after notice and a hearing. Any Federal, State, or local governmental unit that accepts notices of interests or liens in real property shall accept any certified copy of an order described in this subsection for indexing and recording.

STATEMENT OF THE CASE

A. Summary of the Case

This case arises from bankruptcy proceedings in which the district court (and the bankruptcy court, by referral) had subject matter jurisdiction pursuant to 28 U.S.C. §§ 157, 1334.

Petitioner Ronald J. Sommers was appointed as trustee of the bankruptcy estates of two companies—Amco Insurance Agencies, Inc. ("AIA") and Amco Insurance Group ("AIG"). In the AIG case, Sommers agreed not to oppose an order modifying the automatic stay and allowing creditor Wells Fargo Bank of Texas, N.A., to pursue a state court lawsuit against Rehmat Peerbhai, the primary shareholder of AIG and AIA. Wells Fargo settled its claims against Peerbhai and received, among other things, liens on Peerbhai's real estate. But when Sommers later learned that Peerbhai had paid for the real estate using funds that he had pilfered from AIA, the bankruptcy court granted Sommers' request for a substantive consolidation of Peerbhai's bankruptcy estate with AIA's bankruptcy estate. The consolidation nullified the liens that Wells Fargo had received in its settlement with Peerbhai.

The district court ruled that the substantive consolidation was proper. The court of appeals ruled that the substantive consolidation was improper on the grounds that the bankruptcy court, having modified the stay and allowed Wells Fargo to proceed with its claims, could not apply bankruptcy law remedies to nullify the results of Wells Fargo's efforts.

B. Wells Fargo Loaned Money to Peerbhai Relying On the Credit of AIA

Rehmat Peerbhai was the primary shareholder of AIA and the primary shareholder of AIG. In September 2000, Peerbhai approached Wells Fargo to obtain loans, and Wells Fargo extended two loans to Peerbhai and AIG (R. 280). One was a $2.4 million loan to both Peerbhai and AIG, secured by real estate. The other was a revolving line of credit to AIG in the amount of $1.2 million, but with Peerbhai as a guarantor. AIA was not an obligor on either loan, as a co-maker or guarantor. But in deciding whether to make these loans, Wells Fargo reviewed consolidated financial statements of Peerbhai, AIG, and AIA together. Calvin admitted that when Wells Fargo made these loans, it knew that AIA was the primary operating entity; that the source of the income reflected on the consolidated financial statements was AIA; that income from AIA was going to be the primary source for the repayment of the loans; and that apart from AIA, Peerbhai had a negative net worth (R. 366, 368, 370, 373, 377).

Thus, Wells Fargo knew that apart from the assets of AIA, neither Peerbhai nor AIG had sufficient assets with which to repay the loans. Wells Fargo also knew that AIG and AIA were separate corporations—not parent-subsidiary—and that Peerbhai owned both companies. And though AIA never signed a guarantee or note, Wells Fargo nevertheless anticipated that income from AIA operations would provide the primary source for repaying the loans (R. 376, 378).

Up until 1999, the majority of AIA's retail outlets were company stores, but that year Peerbhai began selling AIA company stores to friends, family, and other investors to be operated as franchises. For the most part, however, funds generated by the sale of the stores did not go to AIA; instead, Peerbhai personally collected the proceeds from these transactions. By the end of 2001 there were no more company stores at all – Peerbhai had by then converted the majority of AIA's assets into franchise locations (R. 268-69). Peerbhai also used the Wells Fargo loan proceeds to pay off personal obligations. In 2001, most of AIA's assets were sold to PC Group Acquisition II, Inc., for $1.5 million, with the proceeds paid directly to Peerbhai (R. 247, 349). Peerbhai used those sales proceeds to pay mortgages on real estate that he owned personally.

C. When the Companies Filed Bankruptcy, Wells Fargo Pursued Peerbhai.

In January 2002 Wells Fargo sued Peerbhai in state court, asserting breach of the loan documents. In February 2002, AIA and AIG filed for bankruptcy. Sommers was appointed a trustee in each case. Wells Fargo then asked the court in the AIG case to modify the automatic stay so Wells Fargo could pursue its lawsuit against Peerbhai. Sommers agreed not to oppose the request, and the court modified the stay to allow Wells Fargo to pursue the lawsuit. In April 2002, Wells Fargo and Peerbhai then signed a "Limited Forbearance Agreement" whereby Peerbhai paid Wells Fargo $100,000, agreed to a judgment of about $3.5 million, and gave Wells Fargo liens on his real estate. Wells Fargo knew that Peerbhai had paid the mortgages on the real estate by using funds he had

pilfered from the sale of AIA's assets (R. 214-16, 340-47; Trustee Ex. 144).

The stay was modified a mere six weeks after AIG had filed for bankruptcy. At the time, AIA's statement of financial affairs did not show the extent to which Peerbhai had been looting AIA, and Peerbhai continued concealing that fact. Only after the completion of the creditors' meeting, the examination of Mr. Peerbhai, and inspection of company financial records, did Sommers discover the extent to which Peerbhai had looted AIA. He then asked the bankruptcy court to order a substantive consolidation of Peerbhai and AIA's estates (R. 107-40, 553-61). Peerbhai filed for bankruptcy the day before the hearing on Sommers' application, and so AIA and Peerbhai were both in bankruptcy when the court finally held the hearing on the application.

D. The Bankruptcy Court Concluded That Substantive Consolidation Was Proper.

After a two-day evidentiary hearing on Sommers' application for substantive consolidation, the bankruptcy court made fact findings regarding Peerbhai and Wells Fargo's conduct, finding among other things:

- Peerbhai and AIA commingled assets, treated AIA's assets as Peerbhai's assets, and failed to keep records of the commingling; Peerbhai and AIA effectively operated as a single financial entity prior to the date of AIA's bankruptcy.

- Peerbhai used AIA's corporate status to commit fraud against its creditors.

- Peerbhai took at least $3 million—and probably more—from AIA in the two years before AIA's bankruptcy.

- In making the loans at issue, Wells Fargo did not rely on the separate credit of Peerbhai, AIA, or AIG.

- "Peerbhai treated AIA as an alter ego of himself, taking money out of AIA without observing corporate formalities, usurping corporate assets for his own benefit, and effectively consolidating his own financial being with that of AIA *in a way that could not have been ignored by Wells Fargo . . .*"

- "*In light of Wells Fargo's knowledge and the circumstances surrounding the execution of the Limited Forbearance Agreement,* Wells Fargo is not unfairly harmed by substantive consolidation . . ."

(R. 167-73) (emphasis added).

The court's order for substantive consolidation of the AIA and Peerbhai bankruptcy estates was made retroactive to February 2002, when AIA had filed for bankruptcy. By making the substantive consolidation retroactive to February 2002, the "Limited Forbearance Agreement" signed by Peerbhai in April 2002 was invalidated. In the absence of the substantive consolidation, Wells Fargo would be the beneficiary of nearly $1.5 million worth of AIA assets, which had

been sold and the proceeds applied to mortgages on the real estate that Peerbhai then pledged to Wells Fargo, even though AIA had never been obligated to repay either loan to Wells Fargo.

E. The Court of Appeals Concluded That Modifying the Stay Worked an Estoppel.

Wells Fargo appealed to the district court, which affirmed the bankruptcy court, and Wells Fargo then appealed to the U.S. Court of Appeals for the Fifth Circuit. Throughout the appeals, Wells Fargo never challenged the bankruptcy court's findings—including a finding that "[t]he trustee's agreement to an order lifting the stay in [AIG]'s bankruptcy case does not operate as any form of estoppel against substantive consolidation or against any avoidance actions that the trustee may file after consolidation" (R. 167).

Nevertheless, the court of appeals concluded that the bankruptcy court had improperly granted the substantive consolidation. The court concluded that, because the bankruptcy court had modified the automatic stay and allowed Wells Fargo to pursue the state court lawsuit, the court had acted improperly in "invalidating its authorization some twenty months later" by ordering the substantive consolidation *nunc pro tunc*. The court of appeals concluded that the substantive consolidation was a "reversal of course," an "untimely withdrawal" of the bankruptcy court's "earlier approval" that "contradict[ed] its previous order" and "worked to the significant prejudice of Wells Fargo." *Wells Fargo Bank of Texas, N.A. v. Ronald J. Sommers*, 444 F.3d 690, 695-96 & n.4 (5th Cir. 2006). The court of appeals reasoned as follows:

> The bankruptcy court, by granting the motion to lift the stay, and Sommers, by agreeing to it, explicitly authorized and consented to Wells Fargo's pursuit of state court remedies against Peerbhai. Because of this green light by the bankruptcy court, Wells Fargo expended its time and money to pursue the state court litigation until the suit concluded in the Limited Forbearance Agreement. Yet, when Sommers later filed his motion for substantive consolidation . . . he then sought to undo what he had earlier specifically authorized by applying the consolidation of the estates nunc pro tunc. In granting the motion, the bankruptcy court stated that "[t]he avoidance of the liens granted to Wells Fargo by Peerbhai pursuant to the Limited Forbearance Agreement would simply return Wells Fargo to its position as of the petition date." We think it was a little late for this reversal of course.

Id. at 695. The court of appeals vacated the district court judgment and remanded for further proceedings.

REASONS FOR GRANTING THE PETITION

A. A Conflict Exists Among the Circuits on Whether an Order to Modify the Automatic Stay Has Preclusive Effect.

The circuits are split on whether an order modifying the automatic stay serves to preclude remedies under bankruptcy law that affect the results or relief obtained in the proceedings for which the stay was modified.

1. *In the First, Seventh, Ninth, and Eleventh Circuits, an order to modify the automatic stay is a summary proceeding with no preclusive effect.*

In *Vitreous Steel Products Co. v. Miller*, 911 F.2d 1223 (7th Cir. 1990), the U.S. Court of Appeals for the Seventh Circuit considered the bankruptcy court's decision that claims in an adversary complaint were barred by the order modifying the automatic stay—and ruled that such claims were not barred. During the hearing on the creditor's motion to modify the stay, the trustee argued that the bank acted collusively with another investor to sell the debtor's business and that the bank and the investor ignored the actual value of the assets. *Id.* at 1229. The bankruptcy court modified the stay and specifically found that there had been no collusive effort and that the sale was commercially reasonable. *Id.* One week after the stay was modified, the bank completed its pending foreclosure. *Id.*

The trustee appealed the order modifying the stay and also filed an adversary complaint against the bank and investor, alleging, among other things, fraudulent transfer, fraudulent conveyance, and commercially unreasonable sale. *Id.* at 1230. The bank and investor moved for summary judgment on the complaint, and the bankruptcy court ruled that the above claims were barred, having been decided on the motion to modify the stay. *Id.* But the court of appeals said the claims had not been resolved by the order:

> Collateral estoppel is not a bar because the only issues necessarily decided at the § 362 hearing were whether the Bank had a colorable claim of a lien and whether the amount of that lien exceeded the value of the property. It was not necessary to reach questions of whether [the investor] had colluded with the Bank, or questions of preferential transfers . . . or . . . fraudulent conveyances . . . or commercial reasonableness . . .

Because those issues could not properly be raised at the hearing on the motion to lift the stay, the order lifting the stay was not *res judicata* on those issues." *Id.* at 1234.

In *Grella v. Salem Five Cent Savings Bank*, 42 F.3d 26 (1st Cir. 1994), the U.S. Court of Appeals for the First Circuit adopted the reasoning in *Vitreous Steel* in considering the argument that the "allowance of a motion for relief from stay does not preclude the later prosecution of a preference action" because the later action is not part of the court's decision to grant relief

from stay. The court agreed and ruled that a hearing on a motion to modify the stay was meant to be a summary proceeding and that the Bankruptcy Code required a court to act quickly in such a situation. *Id.* at 32. The court was influenced by what it perceived to be the limitations in the statute's language authorizing courts to modify the stay under certain circumstances. *Id.* This analysis has "led most courts to find that such hearings do not involve a full adjudication on the merits of claims, defenses, or counterclaims, but simply a determination as to whether a creditor has a colorable claim to property of the estate." *Id.*

In *Jim Walter Homes, Inc. v. Saylors*, 869 F.2d 1434 (11th Cir. 1989), the U.S. Court of Appeals for the Eleventh Circuit addressed whether a Chapter 13 plan may cure a home mortgage arrearage when the debtor has already received a Chapter 7 discharge of the underlying mortgage debt. The creditor argued the absence of good faith because the debtor filed the Chapter 13 petition on the day after the bankruptcy court had modified the automatic stay in the Chapter 7 case. *Id.* at 1438. The creditor reasoned that this filing negated good faith because "the lifting of the automatic stay in the chapter 7 case was a final adjudication of [the creditor's] right to foreclose and, under the doctrine of res judicata and collateral estoppel, [the debtor] can no longer question [the] adjudication." *Id.* The court of appeals disagreed and concluded that "in no way did the order [to modify the stay] purport to be a permanent adjudication" of the creditor's right to foreclose. *Id.*

In *In re Taylor*, 884 F.2d 478 (9th Cir. 1989), the U.S. Court of Appeals for the Ninth Circuit examined whether an order to modify the stay in a Chapter 13 case is "entitled to both claim preclusive and issue preclusive effect in subsequent Chapter 13 proceedings." *Id.* at 481. The court stated that the order modifying the stay "was not a 'valid judgment' for purposes of preclusion law." *Id.* at 482. The court affirmed the lower court's decision not to apply *res judicata* to the order. *Id.*

2. *The Fourth and Fifth Circuit Courts give preclusive effect to an order modifying the stay.*

As noted above, the court of appeals concluded in the present case that the substantive consolidation was improper because the bankruptcy court had previously modified the automatic stay and allowed Wells Fargo to pursue the state court lawsuit against Peerbhai. The court of appeals did not cite authority regarding preclusion or estoppel, but that was the court's reasoning. The court said that this was "reversal of course," an "untimely withdrawal" of the bankruptcy court's "earlier approval" that "contradict[ed] its previous order" and "worked to the significant prejudice of Wells Fargo." *Wells Fargo Bank of Texas*, 444 F.3d at 695-96 & n.4. The court of appeals reasoned that the bankruptcy court, by granting the motion to lift the stay, and Sommers, by agreeing to it, "explicitly authorized and consented to Wells Fargo's pursuit of state court remedies against Peerbhai." The court of appeals said this was a "green light" for Wells Fargo, who spent time and money pursuing claims against Peerbhai, only to have the order of substantive consolidation nullify the liens Peerbhai granted to

Wells Fargo in the parties' settlement. The court of appeals said that "when Sommers later filed his motion for substantive consolidation . . . he then sought to undo what he had earlier specifically authorized . . ." *Id.* at 695. The court thus held that Sommer's agreement to allow modification of the stay, coupled with Wells Fargo's pursuit of its remedies, worked an estoppel that prevented Sommers from challenging under bankruptcy law the settlement Wells Fargo had later obtained.[1]

The Fourth Circuit reasoned similarly in *County Fuel Co. v. Equitable Bank Corp.*, 832 F.2d 290 (4th Cir. 1987). In that case, the bankruptcy court had dismissed a debtor's state-court claim against a secured creditor based on *res judicata* grounds. Affirming the dismissal, the court reasoned the debtor's claim was barred by *res judicata*. The court stated that the debtor's failure to

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[1] One finds similar reasoning in the Fifth Circuit in the district court case of *Jefferson v. Mississippi Gulf Coast YMCA, Inc.*, 73 B.R. 179 (S.D. Miss. 1986), where the court had to consider whether a debtor could file an adversary proceeding after the bankruptcy court had issued an order to lift the automatic stay. The court of appeals held "that the lower court's determinations under the law that . . . the Order Lifting the Automatic Stay in appellant's second filing . . . constituted res judicata (or collateral estoppel) [were] correct." *Id.* at 181. The of appeals court stated "[t]he lower court's decision to lift the automatic stay . . . was an act within the discretion of the bankruptcy judge . . . ." *Id.* at 182. The court of appeals further stated that to allow "the debtors to effectively circumvent the effects of the Order Lifting the Automatic Stay by voluntarily dismissing their own bankruptcy and filing a new bankruptcy shortly thereafter would have amounted to a condonation of appellant's attempts to thwart the purposes" of modifying the automatic stay. *Id.*

object or to assert a counterclaim in the bankruptcy proceeding, followed by the creditor's satisfaction of the principal amount of its claim after the stay was modified, as well as the debtor's express concession of the validity of the claim in objecting to the creditor's claim for attorney's fees, sufficed to preclude the debtor's state-court action. *Id.* at 293. Although the court noted that an order modifying the stay should not be considered a final judgment on the merits that would have preclusive effect, the court said that such an order, coupled with the creditor's actions based on the order and the debtor's failure to object to the claim, was properly assigned preclusive effect. *Id.*

B. Giving Preclusive Effect to an Order Modifying the Automatic Stay Contradicts Bankruptcy Statutes and Policy.

The above discussion shows that the court of appeals' decision in the present case represents the minority view on this point. There are sound reasons for this Court to address the issues presented and to adopt the majority view.

1. That an order modifying the stay has preclusive effect is not warranted by the statutory language.

First, there is no hint from the statute's language that an order to modify the automatic stay has or should have preclusive effect on bankruptcy remedies. Section 362(d) of the Code provides that the bankruptcy court can modify the automatic stay in certain circumstances. See 11 U.S.C.A. § 362(d) (West

2004 & Supp. 2006) [*supra* pp. 2-3]. Since the bankruptcy court decided this case, section 362(d) has been amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 2005 U.S.C.C.A.N. (119 Stat.) 23 (codified throughout 11 U.S.C.). But the statute—both then and now—never gave a hint that an order modifying the stay was to have the preclusive effect that the court of appeals gave it here.

The present statute provides that a bankruptcy court may modify or terminate the stay "for cause" or, with respect to a stay of an act against property, if the debtor has no equity in the property and the property is unnecessary for an effective reorganization. *See* 11 U.S.C.A. § 362(d)(1), (2) (West 2004 & Supp. 2006). The recent amendments add additional provisions for modifying a stay with respect to actions against real estate. *Id.* § 362(d)(3), (4). Only in subsection (4), which permits recording the lift-stay order under state property record laws, does language suggest that the order has preclusive effect (on future proceedings in the bankruptcy case)—and the statute provides that a debtor in a subsequent case may have the order set aside "upon changed circumstances or for good cause shown." *Id.* § 362(d)(4). As one court put it: "That the statute sets forth certain grounds for relief and no others indicates Congress' intent that the issues decided by a bankruptcy court on a creditor's motion to lift the stay be limited to these matters" and not be deemed to have finally resolved other matters. *Grella v. Salem Five Cent Savings Bank*, 42 F.3d at 29.

In addition, the language of section 362(e) shows that Congress anticipated a summary proceeding for resolving a request for relief from the automatic stay. If no hearing is held within 30 days of a request, the stay is terminated with respect to the party requesting relief unless the court continues the stay until a final hearing—which itself must be concluded within 30 additional days. *Id.* § 362(e)(1). The matter must be concluded within 60 days in cases where the debtor is an individual. *Id.* § 362(e)(1).

The short time that section 362(e) imposes for resolving the matter conforms with holdings discussed above that the proceedings "are meant to be summary in character" and thus should not be given preclusive effect as a final adjudication on the merits. *See, e.g., Vitreous Steel Products Co. v. Miller,* 911 F.2d at 1232; *Grella v. Salem Five Cent Savings Bank,* 42 F.3d at 32.

2. *Congress's intent was to keep the proceeding to lift the automatic stay a summary proceeding.*

Second, giving no preclusive effect to a lift-stay order conforms with Congressional policy behind the statute. The relevant legislative history states that "the purpose of the automatic stay . . . is protection of the debtor and his estate from his creditors." S. Rep. No. 95-989, at 52 (1978) *reprinted in* 1978 U.S.C.C.A.N. 5787, 5838 (emphasis added). Congress believed that the "expedited hearing" for which section 362(e) provides "will not be the appropriate time at which to bring in other issues, such as counterclaims against the creditor, which, although relevant to the question of the amount of the debt, concern largely collateral or unrelated matters . . . Those counterclaims are not to be handled

in the summary fashion that the preliminary hearing under this provision will be. Rather, *they will be the subject of more complete proceedings by the trustee to recover property of the estate or to object to the allowance of a claim.* However, this would not preclude the party seeking continuance of the stay from presenting evidence on the existence of claims which the court may consider in exercising its discretion [whether to modify the stay]. *What is precluded is a determination of such collateral claims on the merits at the hearing.*" S. Rep. No. 95-989, at 55 (1978) *reprinted in* 1978 U.S.C.C.A.N. 5787, 5841 (emphasis added).

In short, Congress intended that the hearing on the motion to lift the stay would *not* be the place for the bankruptcy trustee to raise claims against the creditor seeking relief from the automatic stay, and that those matters would be reserved for later proceedings—such as occurred in this case. If "what is precluded" at the hearing to lift the automatic stay "is a determination . . . on the merits" of claims against the creditor seeking relief from the stay, then an order that modifies the stay (and any agreement not to oppose such an order) cannot preclude such claims later in the bankruptcy case.

Congress believed that "it is important that the trustee have an opportunity to inventory the debtor's position before proceeding with the administration of the case." By granting the bankruptcy court power to lift the stay, the statute works "to permit proceedings to continue in their place of origin" so as "to relieve the bankruptcy court from many duties that may be handled elsewhere." H.R. Rep. No. 95-595, at 341 (1977), *reprinted in* 19[illegible] U.S.C.C.A.N. 5963, 6297.

Congress recognized, too, that relief from the stay did not guarantee the creditor a recovery: "Though the creditor might not be able to retain his lien upon the specific collateral held at the time of filing, the purpose of the section is to insure that the secured creditor receives the value for which he bargained." *Id.*

The court of appeals' decision in the present case runs squarely against the thrust of the legislative history behind the provision in sections 362(d) and (e) for the lifting of an automatic stay.

3. *Assigning preclusive effect to orders modifying the automatic stay is bad bankruptcy policy.*

The drawing of adverse inferences from a parties' agreement to modifying the automatic stay is simply bad bankruptcy policy. As is discussed above, modifying the automatic stay is a vital tool created by Congress for use in bankruptcy proceedings. It allows claims to be liquidated in a separate proceeding and thereby provides certainty as to the amount of claims—without the unnecessary expense of time and effort, early in the bankruptcy case, determining a creditor's rights *vis-à-vis* the estate.

In addition, under fear that they may be giving away substantive rights under bankruptcy law, parties may hesitate to agree to modify the stay, thereby creating unnecessary procedural disputes. Parties in interest should not be under the threat that an agreement to modify the stay will be raised as an estoppel in future bankruptcy proceedings. A request to modify the stay usually occurs so early in the

bankruptcy case that parties have not done sufficient investigation or discovery to reasonably know or anticipate whether the proceeding for which the stay is modified might, if given conclusive effect, adversely affect the party's interests.

Similarly, the court of appeals' decision may discourage courts from modifying a stay, under the threat that issuance of such an order will preclude bankruptcy remedies against the creditor seeking relief, or will preclude relief regarding what is later determined to be property of the estate under the Bankruptcy Code.

In this case, the court of appeals decided that the trustee's agreement to a modification of the stay precluded the subsequent remedy of substantive consolidation. But the court of appeals' decision that an agreement to lift the stay can bar the trustee from contesting the results of the proceeding for which the stay is lifted could adversely affect a trustee's ability to pursue statutory remedies expressly authorized by the Bankruptcy Code or state statute—such as actions for fraudulent transfer or actions to recover a preference. *See* 11 U.S.C.A. §§ 547, 548 (West 2004 & Supp. 2006). If an agreement to modify the stay gives a party in interest a "green light" to proceed against a debtor or related party, should the agreement bar a subsequent action against the creditor to recover a fraudulent transfer or a preference? Nothing in the case law or the language of the Bankruptcy Code (in section 362 or elsewhere) indicates that an order modifying the automatic stay should adversely effect claims against the creditor or other substantive rights under the Bankruptcy Code or other state and federal law.

4. *Wells Fargo knew that it was taking liens on Peerbhai's real estate paid for with AIA's assets.*

Contrary to the court of appeals conclusions in the present case, the bankruptcy court's order of substantive consolidation *nunc pro tunc* did no unfair harm to Wells Fargo. As noted above, Wells Fargo knew good and well what it was doing when, settling its claims against Peerbhai, it took liens on Peerbhai's real estate—for which the mortages had been paid off using proceeds from the sale of AIA's assets. It did not rely on the lift-stay order as a "green light" for pursuing its legitimate claims against Peerbhai.

Rather, Wells Fargo relied on its knowledge of what Peerbhai had done and its awareness that, as the AIA bankruptcy proceeded, the trustee and AIA's creditors were getting wise about what Peerbhai had done with AIA's assets. That is what the bankruptcy court meant when it found that Wells Fargo did not rely on the separate credit of Peerbhai, AIA, or Group, and when the court expressly took account of "Wells Fargo's knowledge and the circumstances surrounding the execution of the Limited Forbearance Agreement . . ." (R. 169). The court meant that Wells Fargo was "gaming the system."

When Wells Fargo executed the Limited Forbearance Agreement, Wells Fargo knew that Peerbhai had acquired the $1.5 million proceeds from the transfer of AIA's assets and had used most of the proceeds to satisfy Peerbhai's personal real estate debts (R. 340-47). When, early in 2002, Wells Fargo asked Peerbhai to explain what happened to the money he received from the sale of AIA's remaining assets,

Peerbhai supplied a chart reflecting that most of the sales proceeds were applied to the mortgages on his personal real estate holdings—and those real estate holdings were then pledged to Wells Fargo under the Limited Forbearance Agreement (Trustee Ex. 144). Peerbhai resisted disclosing this information at a creditors' meetings—and indeed abruptly terminated the meeting when creditors began questioning AIA's expenditures on Peerbhai's behalf (R. 214-16). Right after that that meeting, Peerbhai and Wells Fargo signed the Limited Forbearance Agreement (R. 215; Wells Fargo Ex. 20), with knowledge regarding the source of the funds.

Thus, in setting with Peerbhai, Wells Fargo knowingly took liens on properties whose mortgages Peerbhai had recently reduced using funds from AIA's assets—all of which Wells Fargo knew. The court of appeals was wrong, therefore, to set aside (without a challenge from Wells Fargo) the bankruptcy court's fact finding that substantive consolidation was fair in the light of "Wells Fargo's knowledge and the circumstances surrounding the execution of the Limited Forbearance Agreement."

When Wells Fargo asked the bankruptcy court to modify the automatic stay so that Wells Fargo could pursue its state court lawsuit against Peerbhai, all the bankruptcy court needed to consider at that point was whether Wells Fargo had a colorable claim as to Peerbhai's property. Section 362(d) did not require the court or Sommers, as trustee, to take discovery on Wells Fargo's knowledge or intent in pursuing that lawsuit. Nothing in the language of section 362(d) or the precedent interpreting it would have allowed that.

It is thus contrary to the Bankruptcy Code to suggest that Sommers should have considered that his agreement not to oppose a modification of the stay might later bar him from pursuing remedies against Wells Fargo on behalf of AIA's estate if it turned out that Wells Fargo was gaming the system.

CONCLUSION

A conflict exists among the circuits on whether a bankruptcy court's order modifying the automatic stay can bar bankruptcy law remedies regarding the subject matter of claims that the order allowed to proceed. The court of appeals' decision here gives estoppel effect to such an order, and that is contrary to Congress' intent and the language of the Bankruptcy Code. Sommers therefore asks this court to grant this petition and reverse the court of appeals' decision.

Respectfully submitted,

STACY OBENHAUS
(Counsel of Record)
JAMES P. REID
DAVID ELDER
LISA HONEY
GARDERE WYNNE SEWELL LLP
3000 Thanksgiving Tower
1601 Elm Street
Dallas, Texas 75201-4761
(214) 999-3000

COUNSEL FOR PETITIONERS